



The PPSA and Commercial Property Leasing

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Summary

- Commercial property leases often include equipment and fittings that may be deemed to be registrable security interests under the Personal Property Securities Act 2009 (PPSA)
- Lawyers acting for landlords should consider whether registration of Personal Property Security (PPS) interests are necessary to ensure that these deemed security interest claims are perfected (i.e. valid and enforceable interests under the PPSA)
- Property lawyers should be aware that fresh security interest registrations should be lodged for all assignees and subtenants
- Bank guarantees are to be preferred to cash deposits (with third party holders) to avoid being deemed a registrable security interest

Key sections of practice paper

- The PPSA – Introduction, terminology and operation
- Application of the PPSA to real property leases
- PPS Leases
- Security deposits v bank guarantees
- Fit-outs
- Disposal of abandoned property
- Using the PPSR
- Due diligence

1. Introduction to the PPSA

The Personal Property Securities Act 2009 (Cth) (PPSA) has completely changed the way that personal property security interests are dealt with in Australia. It follows PPSA-style regimes that were implemented in Canada and New Zealand. Since coming into force on 30 January 2012, it has overridden a patchwork of legislation and has replaced a significant number of different registers with one uniform register, the Personal Property Securities Register (PPSR).

1.1 Definition of personal property

The PPSA defines personal property as being property (including a licence) other than:

- (a) land; or
- (b) a right, entitlement or authority that is:
 - i. granted by or under a law of the Commonwealth, a State or a Territory; and
 - ii. declared by that law not to be personal property for the purposes of the PPSA.

This is obviously a broad definition of “personal property” and includes a wide variety of different types of property.

The types of property that can be subject to a security interest under the PPSA are expansive, and include four categories:

- (a) Tangible property;
- (b) Intangible property;
- (c) All present and after-acquired property; and
- (d) Financial property.

The PPSA has a list of exclusions to which the PPSA does not apply. An example is that the PPSA does not apply to “fixtures”.

1.2 Security Interests

The PPSA introduced new rules for the identification, classification, prioritisation and enforcement of PPS interests.

The PPSA redefined the meaning of “security interest”, giving it a broader definition with an emphasis on substance of the security interest, rather than its form. This means that the categories of security interest can expand into areas not previously considered security interests, i.e. such as equipment hire.

The PPSA lists examples of PPS interests, which include fixed charges, floating charges, chattel mortgages, conditional sale agreements (including agreements with retention of title clauses), hire purchase agreements, pledges, trust receipts, consignments and leases.

1.3 The ‘in substance’ test for a security interest

A “security interest” is defined by the PPSA as “an interest in personal property provided for by a transaction that, in substance, secures payment or performance of an obligation (without regard to the form of the transaction or the identity of the person who has title to the property).” This is revolutionary because it means that a Court will look beyond the form of the transaction to its substance and take positive action to deem a security interest.

In determining what is meant by an ‘in substance’ security interest, we can look to overseas jurisdictions for guidance. The approach taken abroad is to read the section broadly in light of the overarching rationale and policy of the PPSA. Case law in Canada and New Zealand has found that there are four broad elements to a valid security interest in personal property:

- (a) A security interest is consensual/contractual;
- (b) A security interest secures payment or performance of an obligation;
- (c) A security interest relates to personal property; and
- (d) A security interest bestows some form of proprietary right.

Because the PPSA is still a relatively new we can expect there will be new categories of personal property securities that develop. This may present an opportunity for creative lawyers to add value to clients by registering interests for new categories.

1.4 Title is no longer king

Prior to the commencement of the PPSA, establishing who held title to personal property was vital when determining who had priority in a dispute over personal property. The PPSA recognises commercial reality that there may be more than one party claiming a security interest.

Under the PPSA’s rules for determining priority, title is an irrelevant consideration. It is possible for a security interest registered in the PPSR to have priority over an unregistered interest even if the holder of the latter is the registered proprietor. Therefore, under the PPSA title is no longer king.

2. Important concepts and terminology

To understand the scope and application of the PPSA, it is important to begin by outlining some of the essential concepts and terminology it uses:

- The PPSA commenced on 30 January 2012 – this is the Registration Commencement Time;
- The new register (PPSR) can be found online at www.ppsr.gov.au;

- “Personal property” is given a wide-ranging definition of property but excludes land;
- A “security interest” is defined by an “in substance” test;
- A “grantor” is the person who grants the security interest;
- A “secured party” is the person who holds the security interest and there can be more than one party holding an interest in the same personal property;
- “Collateral” is the term used to describe the secured personal property; and
- “Attachment” and “perfection” are both required elements of an enforceable security interest under the PPSA.

2.1 Attachment

Attachment refers to the creation of an interest in personal property that can be enforced against that property. The concept of attachment is a little confusing because the “grantor” of the security interest is the party receiving the property not the “owner” of the property. For example, in a PPS lease it is the hirer who is the “grantor” and the “security party” is the owner of the equipment.

2.2 Perfection

Perfection is the essential step to ensure that a security interest is enforceable against third parties. For any collateral it is completed by registration but in certain circumstances it may be completed by the secured party having control or possession of the collateral.

Section 267 of the PPSA provides that an unperfected security interest will vest in a grantor when the grantor enters formal insolvency. For example, if a creditor has not registered their security interest on the PPSR, a voluntary administrator or liquidator of the grantor may reject their claim for a security interest.

As a consequence, landlords who claim a PPSA security interest will need to register their interest on the PPSR.

This can have quite harsh results for owners of personal property that have not registered their security interests and the failure to register PPS interests can result in a complete loss of title to the property formerly owned and leased to an insolvent company.

2.3 Purchase Money Security Interests

A Purchase Money Security Interest (PMSI) is a new security interest created by the PPSA that protects sellers of personal property by giving them a ‘super-priority’ over other creditors. It is a security interest taken in collateral to the extent that it secures all or part of its purchase price. To protect against losing the interest in an insolvency scenario, this interest is also required to be registered to avoid vesting under section 267 of the PPSA.

3. Timeframes and the transitional period

The key take-away for property lawyers is that there is no protection for agreements that date from before the registration commencement time (i.e. 30 January 2012) and full compliance with the PPSA is required.

One part of the PPSA that has caused some confusion amongst legal practitioners is the transitional provisions and the limitation of their operation. The objective of these transitional provisions was to assist businesses to have a seamless changeover to the PPSA up until 30 January 2014 only.

When the PPSA was enacted, it allowed for a transitional period for existing security interests in personal property. This meant that security interests created before 30 January 2012 or arising out of an agreement

that dated before 30 January 2012 were deemed to have been perfected for a period of 24 months from 30 January 2012. If the interest had not been perfected by registration (or other means provided by the PPSA) by 30 January 2014, it would then be unperfected and it would vest in an insolvency scenario.

It is important to advise clients who may have previously relied on this temporary protection that it is no longer available to them even if the commercial lease pre-dates the PPSA (i.e. before 30 January 2012).

4. Personal property v Land law: The relevance of the PPSA to commercial property leases

A key principle of the PPSA is that it is separate from land law. This means that commercial leases that purely convey interests in land are not affected by the PPSA. However, if a lease also contemplates the lease of chattels, the landlord gives exclusive possession of chattels along with the premises, or if there are clauses dealing with abandoned goods, the landlord may have a registrable PPSA interest.

There are a number of scenarios where the PPSA may become relevant in a commercial or retail lease matter:

- When the landlord also leases chattels;
- When the landlord claims an interest in a tenant's fixtures;
- When the landlord contributes to fit-out;
- When a cash deposit is obtained; and
- When a lease ends and chattels are abandoned.

All of these scenarios are discussed below.

5. When a landlord also leases chattels

A transaction where a landlord leases goods to a tenant (as part of a commercial lease) may give rise to a PPS Lease. Such transactions would include leasing of non-fixed fit-out items, furniture, plant and/or equipment.

The legal effect of the PPSA may be to deem part of a commercial or retail lease as a "PPS Lease". A PPS lease is defined in the PPSA as a lease or a bailment of goods:

- (a) for a term of more than two years from day one of the lease; or
- (b) a lease of up to two years that is automatically renewable for one or more terms that might exceed two year;
- (c) a lease for an indefinite term if the lessee retains uninterrupted possession for more than two years but not until the possession extends for more than two years; or
- (d) a lease of up to two years if the lessor retains continued possession of for a period of more than two years.

According to the 'substance not form of the transaction' principle, the PPSA treats the lessor as a secured party and the lessee as the grantor of the interest. This is contrary to pre-existing law which does not treat a bailment as a security interest.

The question of whether an obligation in a commercial or retail lease creates an 'in substance' security interest in chattels will require consideration of factors including:

- Whether ownership passes to the tenant at some point after the entry of the lease;
- The term of the lease compared to the useful life of the chattels; and

- Whether there is an option to purchase later.

5.1 Exception: Persons not regularly engaged in the business of leasing goods

A PPS lease does not include a lease by a lessor who is not regularly engaged in the business of leasing goods.

This exception has been the subject of judicial consideration in Canadian cases. The Alberta Court of Appeal held that the exception “pertains to whether the lessor is in the business of leasing [and further pointed out that] the focus is the business practice of that lessor”. In another Canadian case, a finance company that occasionally used leases as part of its financing arrangements was found to be regularly engaged in the business of leasing. Moreover, it was held that the number or frequency of leases entered into by the lessor does not matter.

Recently in an Australian case the Court found that this exception was limited and followed the overseas authorities because no Australian authorities were available:

“However, we do not agree that the frequency of leasing is determinative. Rather, we are of the view that so long as leasing was a proper component of the business, it can correctly be said that leasing was regularly engaged”.

Therefore, it would be brave to argue that a commercial landlord would be exempted in most cases when entering into a commercial lease that includes chattels.

6. When the landlord contributes to fit-out or claims an interest in a tenant’s fixtures

Fixtures are defined under the PPSA as “goods, other than crops, that are affixed to land”, and are expressly excluded from the PPSA.

The question of whether the PPSA is applicable to retail and commercial leases where landlords claim interests in a fit-out may come down to the question of whether the fit-out is found to be a fixture or a chattel at law.

Under common law, a fixture is a chattel that has become part of the land through annexation, and is therefore property of the owner of the land.

In *Australian Provincial Assurance Co Ltd v Coroneo* (1938) 38 SR (NSW) 700 at 712, Jordan J observed that:

“A fixture is a thing once a chattel which has become in law land through having been fixed to the land. The question whether a chattel has become a fixture depends upon whether it has been fixed to the land, and if so for what purpose. If a chattel is actually fixed to the land to any extent, by any means other than its own weight, then prima facie it is a fixture; and the burden of proof is upon anyone who asserts that it is not; if it is not otherwise fixed but kept in position by its own weight, then prima facie it is not a fixture and the burden of proof is on anyone who asserts that it is.”

To determine whether chattels have become affixed to land, reference must be had to the objective intention of the chattel’s owner. Relevant factors include the degree of annexation of the chattel to the land and the object or purpose for which it was affixed.

A recent decision confirmed that the common law definition of fixtures was intended to be imported into the PPSA.

6.1 An example: Matter of Cancer Care Institute of Australia Pty Ltd (Administrator Appointed)

An excellent example of where the PPSA and the common law of fixtures overlaps can be found in *Cancer Care Institute of Australia Pty Limited (Administrator Appointed)* [2013] NSWSC 37.

The first defendant, Cortez Enterprises Pty Limited (Landlord) owned a medical centre located in Hurstville, that Cancer Care Institute of Australia (CCIA) occupied as tenant before going into voluntary administration. There was no written lease agreement between CCIA and the Landlord because they were related entities.

In 2009, CCIA contracted to purchase linear accelerators (used for cancer treatment) from Varian Medical Systems Australasia Pty Limited (Supplier) for over \$8m. Varian held a PMSI in the equipment, which they registered on the PPSR. In the proceedings the Landlord claimed that the equipment was a fixture in the premises, and therefore title had passed to them.

Justice Black decided that the machines themselves constituted the equipment and were separate from the steel frames that they were attached to. The steel frames were installed so that they were considered a part of the premises, and the machines themselves were connected to the steel frames.

Justice Black then went on to decide whether the equipment was in fact a fixture in the premises. In doing so, he stated:

“Whether chattels have become affixed to the land, so that they are to be regarded as fixtures and as part of the land, is to be determined by reference to the objective intention of the chattels’ owner, with relevant factors including the degree of affixation of the chattel to the land and the object or purpose for which it was affixed.”

In deciding whether the equipment was a fixture, one of the factors Justice Black took into account was the fact that the equipment was purchased on credit, and that the Supplier retained a PMSI over the equipment. He found the fact that the Supplier had a security interest registered on the PPSR was “inconsistent with any objective intention of CCIA that they would become part of the premises and the property of [the Landlord]”.

The Court found that the linear accelerators were not fixtures because, although the steel base was concreted to the ground, the equipment itself was intended to be removed or replaced at some time.

Justice Black also made some obiter comments regarding tenant’s fixtures:

“Had I held, contrary to the conclusion that I have reached above, that the Equipment had become a fixture, then I would have held that CCIA was entitled to remove the Equipment as a tenant’s fixture. To the extent that such a term was to be implied into the lease in fact, that implication could more readily be drawn given the informality of the relevant tenancy arrangement. The only submission put by [the Landlord] to the contrary was that the removal of the Equipment would cause substantial damage to the Premises. However, that submission depended, first, upon the proposition that the base frame was part of the Equipment, which I have not accepted. I also accept Mr Wellings’ evidence that is a relatively straightforward task to remove the base frame, whether to install the base frame for a linear accelerator manufactured other than by [the Supplier] or so that no base frame remains in the Premises, if [the Landlord] ultimately wishes to do so.”

The result meant that even if the equipment was found to be a fixture, because it was deemed the tenant’s fixture with a right to removal at the end of the lease, the administrators held the right to remove the equipment.

This case may have had a different outcome if there had been a written lease agreement that specifically referred to landlord fixtures. It may have also given the Landlord a PPSA interest in the equipment upon the tenant's insolvency.

7. Landlord fit-outs

7.1 Registration

Landlords often provide incentives that may be used to pay for a tenant's fit-out and the lease may include a clause giving the landlord title to the fit-out. For the purposes of this section it is assumed that the "fit-out" is not a fixture at law and therefore may be personal property covered by the PPSA.

Particular care may need to be taken when acting for a landlord in circumstances where the lease agreement includes the provision of a fit-out at the landlord's expense. Consideration as to whether the fit-out includes chattels or items not found to be affixed to the land (i.e. fixtures) must be taken into account. To err on the side of caution, PPSR registration should be effected in these circumstances so as to avoid administrators or liquidators receiving title of any such fit-outs upon appointment.

7.2 Deemed PPS Lease if for more than 2 years

It may be the case that a landlord's fit-out is deemed to be subject to a PPS Lease. It should be noted however, that the PPSA does not apply to a furnished residential property because there is an exclusion for consumer property.

There are strict timeframes for the registration of the PPS Leases and if these timeframes are missed the priority of the landlord is lost.

8. Security deposits versus bank guarantees

8.1 Cash deposits

In certain circumstances, a cash deposit for a commercial or retail lease may create a PPSA security interest. This is because it is arguable that by setting aside funds to meet lease obligations the tenant has established rights in favour of the landlord that are intended to secure its leasing obligations. It should be noted that a PPS interest would not be created when the landlord holds the deposit themselves on trust or in cash at hand. In a recent case a receiver claimed that monies paid into Court were a PPS interest that vested upon the appointment of a liquidator. The Court found that this was not a "transaction" for the purposes of PPSA because it was not consensual. The monies were in the control of the Court so it was not a PPS interest.

8.2 Bank guarantees

A bank guarantee or personal guarantee will not create a security interest covered by the PPSA. The documents are held by the landlord and there is no "collateral" under the PPSA for this surety.

9. A charging clause over assets of a guarantor creates a security interest

You may come across "all monies" guarantees that give a creditor the right to claim a charge in "all property" owned by a guarantor. Assuming the guarantor holds personal property, this will give rise to a security

interest under the PPSA. Perfection of such an interest will require the creditor to register their interest in the property on the PPSR.

The take-away is that unless this interest is registered it will vest upon the appointment of a trustee in bankruptcy, liquidator or voluntary administrator over the guarantor of the tenant's obligations. Further, registration and documentation requirements of "all present and after-acquired property" will need to be considered.

10. Before disposing of abandoned goods for landlords

Another situation that may arise for lawyers is the application of the PPSA when goods are abandoned on leased premises. A well drafted lease will include a specific timeframe by which a tenant is required to have removed their property, after which, the personal property is deemed to be abandoned.

One way to protect a landlord in such situations would be to include a clause in the lease that gives the landlord the right to sell any property left behind by the tenant at the end of the lease, and to utilize the proceeds to satisfy any debts owed to them by the tenant. This would be an example of a security interest covered by the PPSA.

However, a clause permitting the landlord to treat the property as their own when the lease ends, does not in itself, create a security interest (i.e. deemed abandonment).

The downside with a deemed abandonment clause is that it may be subject to another party's claim (such as a bank's all present and after-acquired property) as a priority.

To minimise risk, landlords should conduct searches on the PPSR before disposing of any abandoned goods left behind by tenants. This is important because any valid registered security interest will have priority over claims made by landlords for abandoned goods. Consideration should be given to registering an interest on the PPSR for both abandoned goods and secured goods.

11. Subsequent assignments and subleases

If there is a subsequent assignment or sublease, any registrations on the PPSR will need to be re-registered to ensure that the PPS interest is perfected. It may be vital to include a clause in the lease requiring consent for assignment or subletting in order to allow time for re-registration. This would apply even if the assignment or sublet tenant was a related entity.

12. What if the secured party doesn't respond to reasonable enquiries?

The Hastie Group case dealt with the rights of equipment owners who had made PPSA registrations but who failed to reasonably exercise their rights under the PPSA. In this case there were 995 registrations on the PPSR when the Hastie Group went into voluntary administration. Most of the equipment, however, remained unclaimed even after the administrators wrote to the secured parties. The Court held that the administrators had the right to dispose of property where the registered security holders failed to respond to repeated requests to pick up the equipment or consent to sale.

13. Perfection generally requires registration of the PPSR

The key point is that if the landlord hasn't registered (i.e. perfected) their security interest, their tenant may grant a security interest over the fit-out or other personal property to a third party. This would result in the

defeat of the landlord's interest in the personal property in an insolvency scenario. Registration is generally required to protect against vesting of PPS interests in favour of insolvency appointees in cases where the tenant appoints a liquidator or voluntary administrator.

14. Using the PPSR

14.1 Not like a Google search

When checking the PPSR, precise spelling and reference details must be entered. In other words, there is no 'wildcard' search that you can utilise like with Google.

You can conduct a PPSR search by reference to the grantor, a serial number or a unique financing statement reference. If it is a company you should conduct searches by both ACN and ABN and if it is a natural person you should search by both full name and any abbreviated names, e.g. Ben Sewell and Benjamin Sewell.

14.2 Authorised purpose

A person must have an authorised purpose for a search if the search is related to an individual grantor. The PPSA sets out which purposes are authorised, but these include a person who is considering extending credit or engaging in financial dealings. You may also seek consent to search if the search doesn't fit a category listed in the PPSA as an authorised purpose.

14.3 Strategic use of the PPSR

Examples of practical ways the PPSR can be used include:

- Financiers taking an interest in searches and registering PMSIs over inventory in order to trump other creditors;
- Solicitors for purchasers examining PMSIs in a sale of business transaction; and
- Suppliers using PPSR searches to evaluate security interests of other suppliers in their customers.

15. Due diligence

If you act for a landlord, it is possible that you may wish to use the PPSR to conduct due diligence. For example, you may use the PPSR to try and assess the solvency of an incoming tenant.

15.1 Limitations of PPSR searches

It must be noted that the PPSR does not require disclosure of all information regarding the security interest or collateral. Instead, the policy behind the PPSR is to create a 'noticeboard' with information limited to:

- (a) the details of grantor and secured party;
- (b) the serial number (i.e. Vehicle Identification Number of a motor vehicle);
- (c) the collateral class (this may just be "inventory"); and
- (d) the term of the security.

No copy of a contract or details of net indebtedness will be provided by a PPSR search. Using PPSR search results for due diligence requires interpretation because a search may list multiple registrations over the same collateral (that is vaguely described) and no underlying contracts or statements of outstanding indebtedness.

15.2 Requests for further information

Your client may be interested in more specific information than what the PPSR search can provide. Under the PPSA, your client may be entitled to request this further information. However, the persons legally entitled to request such information are limited, and can be excluded by a confidentiality clause in the security agreement.

The PPSA permits “an interested person” to request from a secured party certain information regarding that security interest, including a copy of the security agreement (i.e. contract), the quantum of the interest, and a list of the secured personal property.

An “interested person” under the PPSA includes the following:

- (a) the grantor in relation to the collateral in which the security interest is granted;
- (b) a person with another security interest in the collateral;
- (c) an auditor of a grantor, if the grantor is a body corporate;
- (d) an execution creditor with an interest in the collateral; and
- (e) an authorised representative of any of the above.

Subject to exceptions, a secured party who receives a request from an interested person must respond to that request. One of the notable exceptions is where there is a confidentiality agreement between the secured party and the debtor that prohibits the disclosure of such information.

Therefore, if you are drafting a contract that provides for security interest under the PPSA, it would be strategic to include a confidentiality clause to avoid this requirement.

15.3 Pre-PPSA lease due diligence

There is an obvious opportunity to offer to review landlords’ pre-PPSA leases to identify any potential PPSA interests because the transitional provisions have ended and all pre-PPSA leases are now subject to the PPSA. This means any lease that dates before 30 January 2012.

Some things to check may include:

- Fit-out incentives;
- Cash security deposits; and
- Rights to sell abandoned chattels to pay outstanding indebtedness.

15.4 Standard form agreements

It may be worth considering the use of a standard form fit-out and incentive agreement that includes provisions that include:

- A provision that waives the tenant’s right to notification of the registration of a security interest under the PPSA;
- A confidentiality agreement prohibiting the provision of information to interested parties; and
- A PMSI over all fit-out paid for by the landlord and otherwise a PPS interest in all chattels left on the premises.

16. Strategic registrations

16.1 Quasi-fixtures

Although fixtures are specifically excluded from the PPSA, the term ‘fixtures’ is not defined in the PPSA. Questions may arise when it is unclear whether certain property is considered a fixture. It may be strategic to

register a security interest in a quasi-fixture to prevent difficulties in the case of insolvency. This point should also be a consideration when drafting lease agreements.

16.2 Pre-emptive registration

If personal property is registered on the PPSR pursuant to the PPSA, then registration may perfect it against third parties.

This means that if no one else has registered a PPS interest, the usual parties that may claim ownership in insolvency such as a liquidator or landlord may be trumped by a landlord's registration. For this reason, it may be advantageous to advise clients to register security interests where the usual parties have not already done so (such as suppliers or banks).

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